

November 6, 2003

Honorable Mayor and Members
Of the City Council
City of Keego Harbor

Dear Mayor and Council Members:

We have recently completed our audit of the City's financial statements for the year ended June 30, 2003. As a result of our audit, we noted items considered to be reportable conditions as well as other items we feel warrant your consideration. In discussing these items, our letter is divided into an overview of prior year comments and the status of those comments through June 30, 2003 in bullet point format, followed by a narrative of all items which continue to warrant consideration.

<u>Previous Years Audit Comments (June 30, 2002)</u>	<u>Current Status through June 30, 2003</u>
<p>Internal Control Structure</p> <ul style="list-style-type: none"> • Bank and investment accounts were not reconciled on a timely basis • General ledger was not maintained on a monthly basis • Payroll system was not being maintained on a monthly basis 	<ul style="list-style-type: none"> • Investment accounts are now reconciled timely. Bank accounts were not reconciled timely and were completed by an outside firm • General ledger continued not to be maintained on a monthly basis. Reports could not be generated throughout the year that could accurately show the position of the City • It appears the payroll system was being maintained and year end salary balances per your outside payroll company's reports match the general ledger

Previous Years Audit Comments (June 30, 2002)	Current Status through June 30, 2003
<p><u>General Accounting Items</u></p> <ul style="list-style-type: none"> • The budgets, monthly reports, and annual financial reporting did not combine to form a continuous flow of information • Uniform Accounting Procedures Manual was not being followed regarding timeframe for providing information to council • Distribution of property taxes to other units was not performed timely • Payroll taxes and W-2 reporting were not performed accurately. • The payroll account had a balance of approximately \$100,000. Funds should have been transferred out and a minimum balance maintained. • Investment report was not given to council on a timely basis • For bond deposits, a detailed listing was not available that reconciled to the general ledger • Compensated absences were not tracked accurately by the system 	<ul style="list-style-type: none"> • The budget, monthly reports, and annual financial statement continue to be prepared in differing formats, and using different software systems. Monthly reports, when provided, were not complete and accurate • Timeframe for reporting to council was not met during the year • Several instances were noted during the current audit where property taxes were not distributed timely • Noted no payroll tax or W-2 inaccuracies while performing audit testing. • Funds were not transferred out prior to year end. • Clerk/Treasurer provided an investments report which he indicated was presented to the city council. • Bond deposits were reconciled to general ledger within approximately \$11,000 • Compensated absences continued to be tracked inaccurately for the first six months of the fiscal year. A new system was put into place, which appears to be tracking compensated absences accurately on a go forward basis. The new system will have to be adjusted for errors in the prior system that were carried over.

Previous Years Audit Comments (June 30, 2002)	Current Status through June 30, 2003
<p>General Accounting Items (continued)</p> <ul style="list-style-type: none"> • Interfunds were not cleared out at the end of each month • Gas and Weight Taxes were withheld at year end as a result of the failure to file the Act 51 Highway Report. • Form F-65 was not filed timely • Fund balance in the debt service fund exceeded the maximum amount allowed by the State 	<ul style="list-style-type: none"> • Interfunds were not established and cleared out throughout the year for routine transactions. Many of the funds had negative cash at the beginning of the audit. • Reports were filed and the Gas and Weight Taxes were received. Another Act 51 Highway Report will be due by December 31, 2003. • The deadline for filing form F-65 for the year ended June 30, 2003 is due December 31, 2003. • Fund balance in the debt service funds continued to exceed the amount allowed by the State. However, the millage rate for the 2003 property tax levy was adjusted to reduce fund balance to an appropriate level.

ACCOUNTING PROCEDURES REPORT

As you may be aware, Plante & Moran is required to submit an auditing procedures report for the City of Keego Harbor to the Michigan Department of Treasury on an annual basis. The report indicates the City's compliance with certain Michigan Public Acts or required actions that the City should be performing for period ended June 30, 2003. As a result of city deficiencies, we were required to disclose the following:

- There are accumulated deficits in one or more of the City's funds
- There are instances of non-compliance with the Uniform Accounting and Budgeting Act
- The City has been delinquent in distributing tax revenues that were collected for another taxing unit.
- The City uses credit cards and has not adopted an applicable credit card policy.

The City may receive a communication from the Department of Treasury requesting the City to address these matters.

INTERNAL CONTROL STRUCTURE

The concept of "internal control structure" relates to the system of checks and balances intended to safeguard assets and ensure reliability of the accounting data.

The City's policies and procedures that have been put into place, the accounting system, and the environment that the City operates in all interact and together form the internal control structure.

In planning and performing our audit of the financial statements of the City of Keego Harbor as of June 30, 2003, we considered the City's existing internal control structure in order to determine the nature and extent of auditing procedures for the purpose of expressing an opinion on the financial statements and not provide assurance on the system of internal control. However, we noted the certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control system that in our judgment, could adversely affect the City's ability to record, process, summarize and report financial data consistent with the assertions of management, in the financial statements.

During the fiscal year:

- Bank and investment accounts were not being reconciled on a timely basis. A timely, accurate reconciliation must be consistently performed on all significant cash and investment accounts of the City and is part of a sound internal control system.
- The general ledger was not being maintained on a monthly basis. Specifically, receivable and payable balances were not reviewed and adjusted during the course of the year. As a result, accurate monthly reports were not being prepared for the City council or the management team of the City.
- Currently, there are individuals within the accounting department who have the ability to make general journal entries and take cash receipts. The lack of appropriate segregation of duties is a material weakness in the City's internal control system.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level of risk that errors or irregularities in the amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assign functions

Our consideration of the internal control system would not necessarily disclose all matters in the internal control system that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weakness as defined above. However, we consider the lack of timely reconciliation procedures for the bank accounts to be a material weakness in the City's internal control system.

GENERAL ACCOUNTING/REPORTING ITEMS

Cash and Investments

General Disbursing Account - The City's general disbursing account contains approximately \$2,500 of monies that were received for property taxes as of June 30, 2003. These monies from tax collections were deposited in the City's General bank accounts versus the Tax collections bank accounts. The City should investigate to whom the \$2,500 is owed and remit the monies to the appropriate taxing units.

Payroll Account - The payroll cash bank account is used to fund the payroll checks issued by the City as well as all tax withholdings. This account should carry a minimal balance on an ongoing basis. When payroll is run, monies are then deposited in the payroll accounts in the exact amount of the monies to be paid out for employee paychecks and all withholdings. At year end, the account had over \$100,000 in balance. The City should review the payroll account and determine the appropriate amount that should be maintained in this account.

Cash and Investment Statements, and Other Reports - Some of the cash and investment statements, as well as other miscellaneous reports that we reviewed during our audit were addressed to former City personnel. We recommend the City review its cash and investment statements, as well as any other correspondence with outside institutions, to insure that all contact information is current and correct.

Bond Deposits

As reported in the prior year audit, the City does not have a detailed building bond deposit listing that agrees to the general ledger. During the current year, however, progress was made to generate and maintain a listing to track new deposits, and significant work was done to research old building bond deposits. As a result, the amount of the building bond deposits liability recorded on the City's general ledger system differs from detailed record by approximately \$11,000. While significant progress has been made, we encourage the City to continue its efforts to reconcile the detailed listing of building bonds payable to the general ledger.

Compensated Absences

During the current year, the City tracked sick and vacation time for City employees on two different systems. The first system, which was in effect for the first six months of the year, appeared not to be accumulating sick and vacation time properly. The second system, in place for the final six months of the year, appeared to be operating effectively. The second system's beginning balances were based on the ending numbers from the old system. Therefore, while the second system appears to be working properly, it is based on potentially incorrect figures. We recommend that the City review the accumulation of sick and vacation for the first six months of the year and adjust the beginning balance based on this review.

Pay Increases

As part of our audit, we review the personnel files of several individuals to determine whether the rate they are being paid has been approved by City management or City Council.

During the current audit, we noted that there was no documentation supporting the rates that some individuals were being paid. We recommend that the City review personnel files and update the pay rates contained therein. Proper authorization for these rates should also be maintained in these files.

Interfund Activity

Several monthly transactions occur throughout the year, which create interfund receivables/payables. These interfunds should be reconciled at the end of each month and the associated funds transferred. This should help the City better track the cash and investment balances available in each fund on a monthly basis.

Property Taxes

Debt Levy- State law limits the amount of property taxes a municipality can levy, related to voter-approved bonds, to an amount necessary to pay for the next fiscal year's debt service requirements. The amount of property taxes necessary to pay for the next fiscal year's debt service requirements should be determined through consideration of the amount of beginning fund balance, anticipated interest earnings, and the amount of property taxes to be collected, including an estimate of delinquent property taxes.

As discussed during the prior year, it appears that the City may have exceeded the State's limit based on the amount of fund balance remaining in its debt service fund at the end of the year. It is our understanding that the City has addressed this situation by lowering the amount of property taxes it has levied as part of the 2003 tax levy. We suggest that the City continues to review this situation and adjust future tax levies where appropriate. When planning each year's tax levy the City should take into account the carryover fund balance and anticipated interest earnings when calculating the millage rate, and reducing the millage rate as necessary.

In addition, there are questions on the Municipal Finance Qualifying Statement that are designed to facilitate the Michigan Department of Treasury in their monitoring of this limit. If the amount of fund balance in these debt service funds exceeds 150% of the next years principal and interest, the municipality will not qualify to issue municipal obligations without further approval from the State Department of Treasury. The City appears to have less than 150% of the next year's principal and interest in fund balance in its debt service funds.

Delinquent Personal Property Taxes - Currently, delinquent personal property tax listings are not maintained by the City. Once a year the City confirms with the county the amount of delinquent personal property taxes on the county's records and relies on the county to collect these delinquencies. We recommend that the City maintain this information and use the County's records as a check figure to verify the status of delinquent personal property taxes.

Distribution of Property taxes to other units - State statute provides guidelines for the distribution of property taxes collected to other local units. In general, taxes collected by the City on behalf of other governmental agencies should be remitted to those governmental agencies 10 working days after the 1st

Property Taxes (continued)

and 15th of the month, with 10% of the February 28th collection held until tax settlement. During the current year, we noted that there were 2 months where property tax remittances were not being performed timely.

In addition, the current tax collection fund has a balance of approximately \$5,000 at June 30, 2003. The City should disburse these monies to the various taxing units as soon as possible.

Property Tax Reports - Through our review of property taxes, we noted that the form L-4029, used to report to the State the taxable value and millage rates levied by the City, was completed after the due date and contained several errors. The report was completed in September, two months after the related property taxes were levied. In addition, the calculation used to determine the number of mills the City was eligible to levy was incorrect, although the total number of mills levied matched what the council approved. If the council's decision on the number of mills to levy was based on the information used to generate this report, the City's general fund has lost out on approximately \$3,800 of property tax revenue. Also, the taxable value shown on the report did not agree to the assessors warrant. This item did not have an effect on the property tax levy. These problems appear to have been corrected on the L-4029 generated in the current year.

ACH Arrangements

Recently, Public Act 738 was passed, which allows local units of government to make and accept electronic funds transfers (ACH payments), if the local unit adopts a formal policy. While local units of government may have already been using the ACH system for payroll tax remittances and for the direct deposit of payroll, this new law requires a policy to be adopted.

The City Council should consider adopting a policy on ACH arrangements that includes all of the following:

- Designation of an individual as the party responsible for approving payment, accounting, reporting and complying with the ACH policy;
- A statement that this individual is required to submit documentation as follows:
 - Describe the goods or services purchased,
 - The cost,
 - Date of payment, and
 - The department benefiting from the purchase;
- A system of internal controls to monitor the use of ACH transactions; and
- The approval of ACH invoices before payment.

Purchase Policy

During our audit, we noted that there is no formalized purchase policy. We recommend that the City draft a formal document, which describes the process for initiating purchases and the dollar thresholds requiring differing levels of approval. The document should also describe the dollar threshold of items that require informal and formal bids, as well as the number of bids to be taken.

Cass Lake Road Project

As you are aware, the Cass Lake Road project has not been finalized by the Road Commission of Oakland County. During our audit, we discussed potential liabilities related to this project with the Road Commission, and were not able to determine the extent of the liability, if any, which the City may have to pay when the project is closed out. Some of the items which may still be billed by the Road Commission relate to Drain Commissioner expenditures not yet charged to the project, consulting fees, and remediation charges necessary to prepare property associated with the project for sale. Offsetting these expenditures are potential revenues from the sale of the property described above, as well as proceeds from the sale of other right of way properties. The City should continue to monitor this matter.

Non-Motorized Improvements

Section 10k of Act 51 requires recipients of Michigan Transportation Fund revenues to spend an average (over a 10 year period) of not less than 1 percent of these revenues on non-motorized transportation services and facilities. Noncompliance with this requirement may result in the withholding of Michigan Transportation Fund payments. Typically, municipalities whose annual financial report demonstrates noncompliance will be notified by letter.

This letter will instruct the municipality to 1) develop a plan of project expenditures which will return the community to compliance within three years, and 2) have the plan approved by MDOT's Nonmotorized Transportation Coordinator and the municipalities governing body. We recommend the City review its spending on nonmotorized improvements and determine compliance with this requirement to avoid any withholding of payments.

Defined Benefit Pension Plan

As a result of poor market performance and increasing costs, the City's pension plan actuarial valuation at December 31, 2002 calculates the City now has an unfunded actuarially accrued liability of approximately \$272,000. As a result, the City's required employee contribution will increase over the next several years. For the year ended June 30, 2003, the City's required contribution was approximately \$50,000. For the years ended June 30, 2004 and 2005, the required contributions are actuarially calculated to be \$56,304 and \$62,880 respectively.

LEGISLATIVE ITEMS

GASB 34 Reminder

As we have mentioned previously, the GASB has introduced its new financial statement reporting model. It would be an understatement to say that this new reporting model will have a significant impact on the City's finance department. The City needs to consider the following in order to implement the new model:

GASB 34 Reminder (continued)

- Whether any new systems will need to be put into place in order to obtain the data necessary for the new reporting model; examples might include:
- The new capital asset recording requirements that may require new or modified fixed asset reporting software
- New requirements to measure and record employee sick and vacation pay, or retiree health care obligations
- A method to assign charges for services to the specific expenditures to which they relate
- Whether the cost of gathering the data will exceed the benefits derived from the new information (which is intended to include an improved comparability of financial information with other communities)

The City needs to take various steps in the near future to prepare for this new reporting model, including:

- Updating and verifying its fixed asset listing, based on physical observation and estimates (this may also be useful for insurance purposes, both in substantiating a property claim and for ensuring the appropriate limit of property insurance)
- Obtaining an actuarial update of the estimated liability for retiree health care (this might also be useful in evaluating the extent to which the City can currently fund this obligation)

We would be happy to assist the City as necessary for the implementation of this pronouncement.

Revenue Sharing

The City will continue to feel the effects of the slow down in the State's economy. State shared revenue accounts for approximately 19% of the City's total General Fund revenue. Because of slower than anticipated growth in the State's sales tax collections (the sole source of revenue sharing payments to local units of government) and the State's current budget problems, which have resulted in additional appropriation reductions to the revenue sharing line item in the State's budget, revenue sharing payments for the State's fiscal years ending September 30, 2002 and 2003 were less than originally projected.

The previous Governor's original budget recommendation for fiscal year 2002/2003 was to keep total revenue sharing payments to cities, villages, townships, and counties constant (or frozen) at the fiscal year 2001/2002 level. This recommendation would have resulted in a reduction of approximately \$112 million from what the statutory formula would have otherwise allowed. As was well publicized, following the introduction of the previous Governor's fiscal year 2002/2003 budget there was an attempt in July 2002 to eliminate all statutory revenue sharing from the State's 2002/2003 budget. This attempt was not successful and was overridden via a veto by the Michigan Legislature. However, in December 2002, revenue sharing was cut another \$53 million by an Executive Order of the previous Governor.

The budget presented by the new Governor included an overall reduction to revenue sharing payments of 3 percent from the estimated payments for the State's fiscal year ending September 30, 2003. This version of the budget was ultimately adopted by the Michigan Legislature. While the State's budget has been approved for their 2003/2004 fiscal year, it included several very significant assumptions which have not been fully realized. The State Revenue Estimating Conference in October of 2003 addressed these shortfalls and the Governor is currently attempting to remedy the shortfall. Additionally, it is generally acknowledged that the State's budget woes will continue for several more years. As a result,

Revenue Sharing (continued)

we continue to urge the City to be conservative in its estimation of state shared revenue, as this line item in the State's budget remains vulnerable.

We will continue to update the City as developments occur.

Telecommunications Act Revenue

On May 14, 2002, the Governor signed a three bill package (Senate Bills 880,881, and 999) creating a new telecommunications rights-of-way oversight authority (the "METRO Authority") that assesses fees on telecommunications providers using municipal rights-of-way. A portion of these fees are remitted to communities that have opted to comply with the provisions of this new legislation. The City of Keego Harbor has opted to comply with this legislation and will receive their first payment in the spring of 2004. We estimate this payment to be between \$7,000 and \$9,000.

The Telecommunications Act states that the Metro Authority payments should be used for right of way related purposes. Based our discussions with the State, this would allow the City, at a minimum, to spend these funds on activities that would be eligible to be paid for with Act 51 monies. There is ongoing discussion with the State to expand the definition of right away related purposes to include other costs and activities such as street lighting that are not eligible to be paid for with Act 51 funds but are right-of-way related.

Accordingly, based on the State's guidance to date, many local units of government are recording these monies in their Street Funds. We will continue to update the City as developments occur.

Municipal Finance Act Revisions

The Municipal Finance Act was amended during 2001. Beginning after March 2002, communities are now required to submit a qualifying filing once a year with the Michigan Department of Treasury. The old ten day "exemption from prior approval" process has been eliminated and is replaced with this qualification process. This filing will serve as a pre-approval for future debt issues. The current filing is due within six months of the City's year end and is effective for one year thereafter.

We would like to thank the City Council and all City personnel for the courtesy and assistance extended to us during the audit. We would be happy to answer any questions or concerns you have regarding the annual financial report and the above comments and recommendations at your convenience.

Very truly yours,

PLANTE & MORAN, PLLC



David H. Helisek



Leslie J. Pulver